Michigan Law Review

Volume 77 | Issue 5

1979

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By enacting the 1969 Tax Reform Act,[1] Congress created new tax rates for single individuals to reduce the tax advantages enjoyed by married persons.[2] Ironically, the new rates made some married couples — those in which both spouses earn similar incomes — pay higher taxes than identical unmarried couples. What had been the protected class became the abused class.[3] Two examples reveal the discrepancy: a marriage where one spouse earns $12,000 and the other earns $4,000 will pay $127 more than if the pair were single; if both spouses earn $30,000, they will lose $3,970 more to taxes than their unmarried counterparts.[4]

This "marriage penalty" is not inescapable. The Internal Revenue Code determines marital status for tax purposes on December 31 of each year and provides that couples separated on that date under a decree of divorce or separate maintenance shall not be considered married.[5] Thus, a clever couple might benefit from lower tax rates by divorcing on December 30 and celebrating the New Year with remarriage.

Although Congress probably did not expect the 1969 Tax Reform Act[6] to be an incentive for separation, married couples began contemplating tax avoidance by divorce soon after its passage. In 1972, testimony before the House Ways and Means Committee disclosed that "[people] are really considering getting divorced on December 30 and remarrying on January 2. This is a ridiculous situation, but certainly possible; tax savings perhaps could finance a vacation to Haiti in order to get that quick di-

1. Act of Dec. 30, 1969, Pub. L. No. 91-172, 83 Stat. 487 (the relevant portions are codified at I.R.C. § 1(c)).

2. *See* S. REP. No. 91-552, 91st Cong., 1st Sess. 19, 260 (1969), *reprinted in* 1969-3 C.B. 425, 587.

3. Eighteen million married couples faced the disparate rates of the revised tax schedule. *See Tax Treatment of Single Persons and Married Persons Where Both Spouses are Working: Hearings Before the House Comm. on Ways and Means*, 92d Cong., 2d Sess. 96 (1972) (statement of Edward I. Koch) [hereinafter cited as *Hearings*].

4. *Id.* at 80 (statement of Edwin S. Cohen). The marriage tax has withstood constitutional challenge under the due process and the equal protection clauses, Mapes v. United States, 576 F.2d 896 (Ct. Cl. 1978); Johnson v. United States, 422 F. Supp. 958 (N.D. Ind. 1976), *affd. sub nom.* Barter v. United States, 550 F.2d 1239 (7th Cir. 1977), *cert. denied*, 434 U.S. 1012 (1978).

5. I.R.C. §§ 143, 6013.

6. Act of Dec. 30, 1969, Pub. L. No. 91-172, 83 Stat. 487.

vorce."[7] Tax-related divorces received even more public attention in 1976 when the television show "60 Minutes" featured case studies of marriages dissolved to save taxes.[8]

After the "60 Minutes" program, the Internal Revenue Service discussed the problem hypothetically in Revenue Ruling 76-255:[9] If *C* and *D* secure a valid divorce on December 30 in a foreign jurisdiction, and at that time intend to remarry and do remarry in January, can *C* and *D* file returns as single individuals? The Commissioner held:

> Neither section 143 nor section 6013 of the Code or the applicable regulations thereunder contemplates a "sham transaction" designed to manipulate for Federal income tax purposes an individual's marital status as of the close of a taxable year. See Gregory v. Helvering, 293 U.S. 465.
>
> Accordingly, *C* and *D* for purposes of sections 143 and 6013 of the Code were married individuals as of the close of the taxable year 1975. Therefore, for 1975 they must file either a joint Federal income tax return or separate returns . . . .[10]

The Commissioner's Ruling suggests that the Internal Revenue Service will challenge divorces obtained in foreign jurisdictions[11] whenever the couples intend to, and do immediately, remarry. But although the Service has consistently upheld Revenue Ruling

7. *Hearings*, *supra* note 3, at 45 (statement of Florence B. Donahue).

8. CBS News, 60 Minutes, *Marriage and Taxes* (March 7, 1976, produced by M. Goldin).

9. Rev. Rul. 76-255, 1976-2 C.B. 40.

10. *Id.* at 40-41.

11. It is doubtful that the foreign-jurisdiction language in Rev. Rul. 76-255 would be interpreted to limit the holding to divorces in foreign countries. The Service has applied Rev. Rul. 76-255 in two private Letter Rulings: Ltr. Rul. 7835076 (June 1, 1978) and Ltr. Rul. 7830156 (April 29, 1978). Only one of the two Letter Rulings (Ltr. Rul. 7835076) involved a divorce in a foreign nation.

However, the challenge of a divorce in a foreign country as a sham may have greater merit than an attack on a state divorce decree. Foreign divorce decrees are entitled not to full faith and credit, but rather to comity. The relationship between the two was explained by the Ninth Circuit in Montemurro v. Immigration & Naturalization Serv.:

> The Mexican divorce decree was not entitled to recognition by virtue of the Full Faith and Credit Clause of the Constitution (Art. IV, Sec. 1) but rather was governed by considerations of comity. "Thus, under comity — as contrasted with full faith and credit — our courts have power to deny even prima facie validity to the judgments of foreign countries for policy reasons, despite whatever allegations of jurisdiction may appear on the face of such foreign judgments."

409 F.2d 832, 833 (9th Cir. 1969) (quoting Rosenbaum v. Rosenbaum, 309 N.Y. 371, 375, 130 N.E.2d 902, 903 (1955)).

Therefore, a court might find that a divorce in a foreign country for tax purposes would violate public policy while feeling bound by a similar state decree. The Service, however, has yet to draw this distinction.

76-255 in subsequent letter rulings[12] only recently has it challenged a year-end divorce scheme in court.[13]

This Note examines the propriety of applying the sham doctrine to tax-motivated divorces. Section I outlines the evolution of the sham doctrine from its exposition in *Gregory v. Helvering*[14] through its expression in two different tests for commercial transactions. Section II then studies the relationship between state divorce law and the marital status provisions of the Internal Revenue Code[15] to demonstrate the clear congressional preference for incorporating state law by reference rather than creating an independent federal law of marriage. It also examines the history of the 1969 Tax Reform Act in a vain effort to discern a congressional desire to impose a marriage penalty. Finally, Section III concludes that the IRS should not be permitted to use sham theory to attack year-end divorces until it receives an explicit congressional directive to that effect.[16]

I. GREGORY V. HELVERING AND THE TAX SHAM DOCTRINE

In 1935, the Supreme Court in *Gregory v. Helvering*[17] enunciated guidelines for declaring a transaction a sham. Gregory owned United Mortgage Corporation, which held 1000 shares of Monitor Securities Corporation stock. She created a new corporation, Averill, and transferred the Monitor shares to the new com-

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12. Ltr. Rul. 7830156 (April 29, 1978); Ltr. Rul. 7835076 (June 1, 1978).

13. The Service finally decided to test Rev. Rul. 76-255 when it challenged the returns of Angela and David Boyter. The Boyters have divorced and remarried around New Year's three times since 1966, admittedly for tax purposes. New York Times, Sept. 11, 1979, § A, at 11, col. 1. They filed separate actions contesting the Service's challenge. David Boyter v. Commissioner, No. 11445-77 (T.C., filed Nov. 16, 1977); Angela Boyter v. Commissioner, No. 11446-77 (T.C., filed Nov. 16, 1977).

14. 293 U.S. 465 (1935).

15. I.R.C. §§ 143, 6013.

16. This Note analyzes only the feasibility of attacking year-end divorces under the sham doctrine. The Service might also attack a year-end divorce in a foreign jurisdiction by alleging that it is invalid under the law of the couple's domicile. This tactic has the advantage of maintaining the deference that the Service and the federal courts have accorded to state determinations of marital status. *See* notes 39-67 *infra* and accompanying text. However, the Service would face two imposing obstacles should it choose such an attack. First, it is unclear whether the Service, as a third party, would have standing to challenge the validity of the couple's foreign divorce decree under the law of their state of domicile. Second, even if the service had standing, the domicile state is likely to recognize the foreign decree as long as the divorce proceeding is not ex parte. *See* R. LEFLAR, AMERICAN CONFLICTS LAW § 224 (3d ed. 1977). And couples sufficiently sophisticated to invest the time and expense involved in a year-end divorce scheme are not likely to sabotage that scheme with an ex parte divorce.

17. 293 U.S. 465 (1935).

pany, personally receiving Averill's shares in return. When Averill dissolved six days later, Gregory acquired the Monitor shares and claimed that she did not have to recognize income, since the transfer derived from corporate reorganization.

Although the creation of Averill and the transfer of the shares fit the statutory definition of reorganization,[18] the *Gregory* Court found that Congress intended a corporate reorganization to be motivated by a "business or corporate purpose" other than tax reduction.[19] The Court held that since Gregory created Averill only to convey stock, her reorganization was not within the purview of the statute. In reaching this conclusion, the *Gregory* Court articulated the basic tenet of the tax sham doctrine:

> The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits cannot be doubted. . . . But the question for determination is whether what was done, apart from the tax motive, was the thing which the statute intended.[20]

Thus, if a transaction "lies outside the plain intent of the statute,"[21] then to uphold it "would be to exalt artifice above reality and to deprive the statutory provision . . . of all serious purpose."[22] That principle gives courts a tool for voiding transactions that fit within the letter, but not the spirit, of the tax code.[23]

Courts have used two different tests to appraise transactions under *Gregory*. The first — the "beneficial interest test" — was inspired by Learned Hand's dissent in *Gilbert v. Commissioner*.[24] According to Hand,

> If . . . the taxpayer enters into a transaction that does not appreciably affect his beneficial interest except to reduce his tax, the law will disregard it. . . . When a taxpayer supposes that transaction, in addition to its effect on his tax, will promote his beneficial interests in the venture, he will of course secure the desired reduction.[25]

Courts adopting the beneficial interest test are concerned primarily with whether "there was any significance to what the parties

18. Revenue Act of 1928, Pub. L. No. 70-562, ch. 582, § 112(g), 45 Stat. 791, 818.

19. 293 U.S. at 469.

20. 293 U.S. at 469.

21. 293 U.S. at 470.

22. 293 U.S. at 470.

23. *See* Estate of Parshelsky, 303 F.2d 14, 17 (2d Cir. 1962), where the court declared that a transaction must be within the "spirit of the [relevant tax code] section."

24. 248 F.2d 399 (2d Cir. 1957).

25. 248 F.2d at 411.

did,"[26] and they usually infer "significance" from the commercial risks in the transaction. Significantly, under the beneficial interest test a tax-reduction motive is not fatal if the transaction exposes the taxpayer to a genuine commercial risk. According to the Supreme Court's latest exposition of the sham doctrine, "even a 'major motive' " to mitigate one's taxes "will not vitiate an otherwise substantial transaction."[27]

The Seventh Circuit's decision in *Maysteel Products, Inc. v. Commissioner*[28] clarifies the contours of the beneficial interest standard. Maysteel bought $100,000 in bonds, financing the purchase through a promissory note. The corporation amortized the bond premium and deducted the amortization from its return. A month later Maysteel donated the bonds, subject to its indebtedness, to a charitable foundation. The foundation sold them at an appreciated value while Maysteel claimed a charitable deduction. The Commissioner contested the amortization deduction, claiming that the bond purchase was a sham transaction "outside the plain intent of the statute."[29] The court allowed the deduction, responding:

> While the end result here was a gift — not a business transaction — the bond purchase, loan, note or pledge of collateral, sale of bonds, and satisfaction of the loan were in every respect genuine financial and commercial transactions. They were real in every sense. And the taxpayer was exposed to all of the usual risks involved in such transactions. It incurred genuine obligations; risks and obligations beyond its control. . . . Taxpayer incurred the risk of loss in event of decline in the market; was entitled to benefit from any advance; it was not bound to make the gift it ultimately did but could have retained the benefits of the transaction.[30]

26. Rothschild v. United States, 407 F.2d 404, 408 (Ct. Cl. 1969).

27. United States v. Consumer Life Ins. Co., 430 U.S. 725, 739 (1977). *See also* Knetsch v. United States, 364 U.S. 361 (1960).

28. 287 F.2d 429 (7th Cir. 1968). For other cases applying the beneficial interest test, see Commissioner v. Brown, 380 U.S. 563 (1965); Blueberry Land Co. v. Commissioner, 361 F.2d 93 (5th Cir. 1966); Halle v. United States, 346 F.2d 543 (4th Cir. 1965); Humphreys v. Commissioner, 301 F.2d 33 (6th Cir. 1962); Evans v. Dudley, 295 F.2d 713 (3d Cir. 1961), *cert. denied,* 370 U.S. 909 (1962); Fabreeka Prods. Co. v. Commissioner, 294 F.2d 876 (1st Cir. 1961); Diggs v. Commissioner, 281 F.2d 326 (2d Cir.), *cert. denied,* 264 U.S. 908 (1960); Granite Trust Co. v. United States, 238 F.2d 670 (1st Cir. 1956); L. Lee Stanton, 34 T.C. 1 (1960). When it approved the holding in *Granite Trust,* the Service apparently embraced the notion that the taxpayer's motive is irrelevant if the transaction affects a beneficial interest. Rev. Rul. 78-285, 1978-2 C.B. 6.

29. 287 F.2d at 430.

30. 287 F.2d at 431.

Hence, the beneficial interest test winnows out only those commercial schemes that create no risks or cause no substantive change in the taxpayer's position.[31]

The second approach courts take when deciding whether a transaction is a sham hinges upon the taxpayer's motivation.[32] Although the *Gregory* Court conceded that taxpayers have a legal right to reduce their taxes, it also held that a legitimate corporate reorganization must have a nontax purpose. Courts using the motive test have interpreted *Gregory* to mean that transactions solely or substantially motivated by tax considerations should be disregarded for tax purposes.[33]

The holding of the court in *Brooke v. United States*[34] illustrates the motive test. Brooke, a doctor, gave an office building to his children, holding and renting it as their guardian. The Commissioner challenged the transfer as a sham and refused to recognize the father's rent deductions, alleging that Brooke conveyed the building only to gain those deductions. The taxpayer presented a lengthy list of nontax motives for the transaction: to provide for the health and education of his children through the rent received in trust; to avoid friction with his partners in medical practice; to insulate assets from the threat of a malpractice suit; and to diminish the ethical problem stemming from his

31. As applied in Gregory v. Helvering, 293 U.S. 465 (1935), the beneficial interest is deceptively simple. The *Gregory* Court nullified the tax effects of a transaction that involved no significant business risks. After stating that a reorganization required a business purpose in order to avoid recognition, the Court reasoned that no such purpose was present because the new corporation undertook no substantive transactions.

32. It would be misleading, however, to suggest that courts applying the motive test will not also consider the risks involved in the transaction. On the other hand, courts using the beneficial interest test are not above peeking at the taxpayer's motives. Indeed, the varied interpretations of the *Gregory* holding led two commentators to state that the decision is "all things to all men." B. BITTKER & L. STONE, FEDERAL INCOME ESTATE AND GIFT TAXATION 739 (4th ed. 1972). *See also* Blum, *Knetsch v. United States: A Pronouncement on Tax Avoidance,* 1961 SUP. CT. REV. 135, 140. Most courts apply the motive test where the transaction they wish to invalidate has commercial substance. For a more thorough discussion of the interrelationship between the two standards, see Gunn, *Tax Avoidance,* 76 MICH. L. REV. 733 (1978); Blum, *Motive, Intent, and Purpose in Federal Income Taxation,* 34 U. CHI. L. REV. 485 (1967); Fuller, *Business Purpose, Sham Transactions and the Relation of Private Law to the Law of Taxation,* 37 TUL. L. REV. 355 (1963).

33. For courts applying the motive standard, see Barnett v. Commissioner, 364 F.2d 742 (2d Cir. 1966), *cert. denied,* 385 U.S. 1005 (1967); Kocin v. United States, 187 F.2d 707 (2d Cir. 1951); Slifka v. Commissioner, 182 F.2d 345 (2d Cir. 1950). Courts using the motive test are in a definite minority. Furthermore, the doctrine has recently come under criticism. According to Gunn, "the question whether particular conduct was tax-motivated should be irrelevant to the decision whether that conduct should be taxed in a certain way." Gunn, *supra* note 32, at 765.

34. 468 F.2d 1155 (9th Cir. 1972).

ownership of a medical practice in the building in which one of the tenants was a pharmacy.[35] The court stated that "a transfer solely to avoid taxes will not be recognized" but held that Brooke's gift was not a sham since "[t]he non-tax motives, as borne out by the record, are abundant and grounded in economic reality."[36]

Revenue Ruling 76-255 seeks to apply the sham doctrine to divorce procedures. To support that ruling, the IRS bears a heavy burden, for *Gregory* and its successors have applied the doctrine only in cases where it is essential to protect a clear legislative purpose.[37] The remainder of this Note demonstrates that any strong legislative desires are opposed to federalizing divorce law, that the most plausible goal protected by applying sham doctrine to year-end divorces — taxation of married couples at a higher rate than individuals — is not a clear congressional desire, and that neither of the two sham doctrine tests are tailored to analyze the year-end divorce situation.

II. The Federal Tax Laws, State Marriage Laws, and Congressional Intent

Gregory authorizes a court to declare a formally valid commercial transaction invalid for tax purposes whenever the beneficial interest test or the motive test reveals that the transaction is not one that Congress intended the relevant Code provision to cover. Under Revenue Ruling 76-255,[38] the Internal Revenue Service has chosen to use *Gregory* to challenge year-end divorce and remarriage schemes. This Section probes two necessary assumptions that the Service must make about congressional intent before it can invoke *Gregory*: that Congress intended to create a federal marital status independent of state laws, and that Congress had a clear purpose to impose a marriage penalty. If the

35. 468 F.2d at 1158.

36. 468 F.2d at 1158.

37. Courts impose this heavy burden on the IRS in sham cases because the Service challenges transactions that comply with the letter of the tax statutes. *See* Rice, *Judicial Techniques in Combating Tax Avoidance*, 51 Mich. L. Rev. 1021 (1953). The challenged transaction's literal conformance to the applicable statute requires the IRS to demonstrate, as the Court held in *Gregory v. Helvering*, that "the transaction upon its face lies outside the plain intent of the statute." 293 U.S. at 470. Consistent with the *Gregory* holding, many courts have stated that "unless Congress makes it abundantly clear," tax statutes should not be construed to "be dependent upon the discovery of a purpose, or a state of mind . . . ." Fabreeka Prods. Co. v. Commissioner, 294 F.2d 876, 878 (1st Cir. 1961). *See also* Henry McK. Haserot, 41 T.C. 562, 571 (1964).

38. Rev. Rul. 76-255, 1976-2 C.B. 40.

Service cannot support both assumptions, it will not have met the sham doctrine's requirement of a clear congressional purpose, and enforcement of Revenue Ruling 76-255 must fail.

A. *State Law and the Marital Status Provisions of the Revenue Code*

Given the intimate relationship between state law and the institution of marriage,[39] it is not surprising that courts have always used state law to determine marital status under the federal tax laws.[40] Before Congress adopted the 1954 Internal Revenue Code, courts consistently held that state law defined marital status for deductions and for eligibility to file joint returns. In the most cited decision, *Marriner S. Eccles*,[41] Mrs. Eccles filed for divorce in Utah and received an interlocutory decree on August 2, 1949, that became absolute in February of 1950. Mr. Eccles filed a joint return[42] for 1949, and the Commissioner challenged it, arguing that the interlocutory decree had legally separated the parties. The court held that under Utah law the interlocutory decree did not "end the matrimonial status of the parties, nor destroy the economic and social incidents inherent in marriage."[43] To complete its syllogism and reject the Commissioner's view, the court held that state law determined the couple's marital status for tax purposes:

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39. In Pennoyer v. Neff, 95 U.S. 714, 734-35 (1877), the Court stated: "The State . . . has absolute right to prescribe the conditions upon which the marriage relation between its own citizens shall be created, and the causes for which it may be dissolved."

In Barber v. Barber, 62 U.S. (21 How.) 582, 584 (1858), the Court stated, "We disclaim altogether any jurisdiction in the courts of the United States upon the subject of divorce." *See also* Simms v. Simms, 175 U.S. 162, 167 (1899).

40. It is well settled that state law does not, by its own force, control the application of federal tax provisions. Nonetheless, the Supreme Court has held that state law may control where the federal statute, by necessary implication, depends upon it. Barnet v. Harmel, 287 U.S. 101, 110 (1932). *See also* Lyeth v. Hoey, 305 U.S. 188, 194 (1938); Cahn, *Local Law in Federal Taxation*, 52 YALE L.J. 799, 816 (1943). Courts can draw the necessary implication that marital status under state law is controlling for tax purposes because the legislative history of the predecessors of § 6013 and § 143 of the 1954 Code — 26 U.S.C. § 51(b)(1939) and 26 U.S.C. § 23(aa)(6)(1948) — shows no evidence that Congress intended to create an independent federal law to govern marital status.

41. Marriner S. Eccles, 19 T.C. 1049, *nonacq.* 1953-2 C.B. 8, *affd. per curiam*, 208 F.2d 796 (4th Cir. 1953). For other cases following *Eccles*, see Commissioner v. Ostler, 237 F.2d 501 (9th Cir. 1956); Holcomb v. United States, 137 F. Supp. 619 (N.D. Cal. 1955), *affd.*, 237 F.2d 502 (9th Cir. 1956); Alice Humphrey Evans, 19 T.C. 1102 (1953), *nonacq.* 1953-2 C.B. 8, *affd.*, 211 F.2d 378 (10th Cir. 1954).

42. At the time, the joint return provision was § 51 of the 1939 Code, Int. Rev. Code of 1939, ch. 1, § 51, 53 Stat. 27, *as amended by* Act of Oct. 20, 1951, Pub. L. No. 81-183, ch. 521, § 312, 65 Stat. 452, 488 (current version at I.R.C. § 6013).

43. Marriner S. Eccles, 19 T.C. at 1051.

> Subsection (b)(5)(B) of section 51 [states] "an individual who is legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married," for purposes of filing a joint return.
>
> It is plain that whether the petitioner here meets the basic test imposed by the language set forth above depends upon his marital status as determined by state law for the marital relation. Marriage, its existence and dissolution, is particularly within the province of the states.[44]

After Congress enacted the 1954 Code, courts had to decide whether the new marital status provisions of sections 143 and 6013 also looked to state law.[45] Most concluded that Congress intended state law to control marital status under the revised Code, apparently finding that *Eccles* court's reasoning still persuasive.[46] Of course, where local authorities disagreed about the validity of a couple's divorce decree, federal courts had to look beyond provincial law;[47] at the very least, they had to choose which state's laws to respect.

General Counsel Memorandum 25250[48] was the first IRS opinion to address the problem of choosing among conflicting determinations of marital status by different jurisdictions. In the memorandum case, the husband and wife divorced in Mexico during 1935. The husband made alimony payments as prescribed by a previously signed separation agreement. In 1943, the wife,

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44. 19 T.C. at 1051. *See also* J.R. Calhoun, Jr., 27 T.C. 115 (1956).

45. The legislative history of § 6013 and § 143 provides little assistance for this endeavor. The committee reports accompanying the 1954 Code indicate generally that Congress made no substantive change in the marital status provisions of the 1939 Code. *See* H.R. REP. No. 1337, 83d Cong., 2d. Sess., *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4025, 4176, 4543; S. REP. No. 1622, 83d Cong., 2d. Sess., *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4621, 4827, 5211; and note 40 *supra*.

46. The reasoning in Lee v. Commissioner is typical:

> [W]e must face the question whether for Federal income tax purposes the term "husband and wife" is to be construed with reference to State law governing the definition and characterization of marital relationships, or whether Congress intended some nationwide, Federal standard under which a couple could be "husband and wife" for purposes of section 6013 even if under the laws of their particular State they would not have that status. This Court has continuously held that for purposes of section 6013 and other Code provisions the marital status, its existence and dissolution, is defined by State rather than Federal laws.

64 T.C. 552, 556 (1975). For a similar view, see John T. Untermann, 38 T.C. 93 (1962).

47. Outside of the conflicts cases, one decision exists denying the conclusiveness of state court determinations of marital status. In Daine v. Commissioner, 168 F.2d 449 (2d Cir. 1948), the Second Circuit held that a state's retroactive judgment of divorce would not affect the marital status of the individual for tax purposes in the prior years.

48. G.C.M. 25250, 1947-2 C.B. 32.

following advice that her divorce would probably not be recognized in a state court, obtained a second divorce in Nevada. The issue was whether the alleged invalidity of the Mexican decree disqualified the husband's alimony deductions[49] taken prior to the Nevada divorce. Even though the Chief Counsel considered it "unlikely" that the couple's state of marital domicile would recognize the Mexican decree, he opined that the deductions were within "the general intent of Congress in enacting" the alimony provisions of the 1939 Code.[50] The memo indicated that the couple's "good faith" reliance on the Mexican decree would bring the alimony deductions within the intent of Congress.[51]

The Third Circuit followed General Counsel Memorandum 25250 in *Feinberg v. Commissioner*,[52] where a New York court invalidated a Florida divorce and the Commissioner disallowed the husband's alimony deduction. The *Feinberg* court upheld the deduction, claiming that the "mere fact that the marital domicile of the parties [New York] did not recognize the Florida divorce does not render it a nullity for Federal income tax purposes."[53] The court noted that, as in General Counsel Memorandum 25250, the husband had relied on the foreign decree.[54]

Both *Feinberg* and the General Counsel Memorandum lay dormant for over a decade until the Second Circuit decided *Estate of Borax v. Commissioner*.[55] Herman Borax had obtained a Mexican divorce on August 7, 1952, and remarried later that month. His first wife challenged the divorce in New York, their domicile, and received a decree of invalidation in February 1953. The Commissioner claimed that Herman and his second wife were not legally married and therefore could not file a joint return. The Second Circuit held that, for tax purposes, the Mexican divorce was controlling:

49. Int. Rev. Code of 1939, ch. 1, §§ 22(k), 23(u), *added by* Act of Oct. 21, 1942, Pub. L. No. 77-753, ch. 619, § 120, 56 Stat. 798, 816 (current versions at I.R.C. §§ 71, 215).

50. G.C.M. 25250, *supra* note 48, at 33.

51. *Id.* The Service cited H.R. REP. No. 2333, 77th Cong., 1st Sess. (1942), *reprinted in* 1942-2 C.B. 372, as evidence that Congress considered good faith reliance a factor in determining marital status for tax purposes. However, an examination of the sections of the report that discuss marital status provisions does not indicate the specific method by which Congress intended marital status to be determined. *See* 1942-2 C.B. 409-10, 427-29.

52. 198 F.2d 260 (3d Cir. 1952).

53. 198 F.2d at 263.

54. 198 F.2d at 263.

55. 349 F.2d 666 (2d Cir. 1965), *cert. denied*, 383 U.S. 935 (1966). Later the same year, the Second Circuit followed *Borax* in Wondsel v. Commissioner, 350 F.2d 339 (2d Cir. 1965), *cert. denied*, 383 U.S. 935 (1966).

> [F]or purposes of these provisions of the federal tax statute, and within the meaning of these provisions, . . . for the years in dispute Ruth and Herman were divorced under a decree of divorce. The subsequent declaration of invalidity by a jurisdiction other than the one that decreed the divorce is of no consequence under these provisions of tax law.[56]

The court cited two justifications for respecting the issuing jurisdiction's judgment of validity of a divorce decree. The first was the need for a uniform determination of marital status under the federal tax laws. The court noted that rote reliance upon state law to determine marital status breaks down when a divorce decree is considered valid by one jurisdiction and invalid by another.[57] It stated that "the Supreme Court is not in a position to resolve all such sister-state conflicts . . . and it would not be advisable for this court (or the Tax Court) to attempt such a resolution in these most collateral tax-deficiency proceedings."[58] Therefore, the court held that

> the rule of validation avoids a measure of unevenness and uncertainty: all those taxpayers who have obtained a divorce in a particular jurisdiction are treated the same, regardless of whether the spouse against whom the divorce has been obtained is able to, and does, invoke the power of another jurisdiction to declare that divorce invalid.[59]

As its second justification for recognizing the Mexican divorce, the *Borax* court adopted the reliance reasoning of *Feinberg*[60] and General Counsel Memorandum 25250: for all practical purposes, Herman and his first spouse were divorced — they had ceased living together, and Herman had in good faith sought and received a decree of divorce.[61] The *Borax* court held that to upset these "pre-existing arrangements" would be contrary to

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56. 349 F.2d at 670.

57. The *Borax* court relied on the Nevada Supreme Court decision in Colby v. Colby, 78 Nev. 150, 369 P.2d 1019, *cert. denied,* 371 U.S. 888 (1962). In *Colby,* the wife received a Nevada divorce. Her husband went to Maryland and received an invalidation decree from the Maryland court. The husband then returned to Nevada to nullify the Nevada decree. The Nevada court denied relief, stating that it would not give "greater credit and respect" to a foreign decree than to a lawfully entered decree in its own state. 78 Nev. at 157, 369 P.2d at 1023. The *Colby* facts illustrate how a couple can be considered married in one jurisdiction and divorced in another. While most courts have accepted the validity of the *Colby* holding, at least one article has questioned its constitutionality. *See* Spolter, *Invalid Divorce Decree,* 24 TAX L. REV. 163, 193-96 (1969).

58. 349 F.2d at 670.

59. 349 F.2d at 670.

60. 198 F.2d at 260.

61. 349 F.2d at 670-71.

congressional desires.[62]

Although the two *Borax* arguments — uniformity and reliance — convincingly demonstrate that *some* choice of state law must be made, they do not necessarily explain why the law of the issuing jurisdiction is the best law to use. At least superficially, it would appear that consistent reliance on the law of a couple's marital domicile would serve those policy goals just as well as reliance on the law of the issuing jurisdiction.[63] Indeed, ten years after *Borax* the Second Circuit severely limited that opinion's scope in *Estate of Goldwater v. Commissioner.*[64] *Goldwater* looked to the law of the marital domicile, holding that the *Borax* rule applied only to the Code sections relating to alimony deductions.[65] But while the *Borax-Goldwater* debate continues within and without the Second Circuit, both sides agree to a principle of supreme importance to the sham doctrine question: there is no federal law of marriage and divorce.[66] The federal courts always

62. 349 F.2d at 671. The *Borax* opinion also contained dicta suggesting the possibility of federal procedural standards for determining the tax validity of a divorce. The Second Circuit noted that the Mexican concept of a divorce, although it had extreme elements, was not "totally alien to that contemplated by the tax laws." 349 F.2d at 672. The court indicated that in particularly unusual divorce proceedings, the question was not whether the foreign divorce would be "declared invalid in every state" but rather whether the divorce frustrated the tax laws. 349 F.2d at 673.

Several commentators have concluded that *Borax* spawned a federal law of marriage and divorce for tax purposes. *See generally* Fried, *External Pressures on Internal Revenue: The Effect of State Court Adjudications in Tax Litigation,* 42 N.Y.U. L. REV. 647, 653 (1967); Rodgers & Rodgers, *The Disparity Between Due Process and Full Faith and Credit: The Problem of the Somewhere Wife,* 67 COLUM. L. REV. 1363, 1385 (1967); Spolter, *supra* note 57. One article has argued that *Borax* did not create a federal tax law of marital relations. *See* Note, 9 CONN. L. REV. 282, 287 (1977).

63. In fact, the majority of courts facing the *Borax* problem have turned to the law of the couple's domicile instead of the issuing jurisdiction to determine a couple's marital status. *See, e.g.,* Capodanno v. Commissioner, 69 T.C. 638 (1978); Irving A. Sheppard, 32 T.C. 942 (1959). *See also* cases cited in note 40 *supra.*

64. 539 F.2d 878 (2d Cir.), *cert. denied,* 429 U.S. 1023 (1976).

65. 539 F.2d at 881. *Goldwater* may be the death knell for the *Borax* rule. The court in *Goldwater* declared that "*Borax* was concerned with the provisions of the federal income tax law concerning the deductibility of alimony payments. The court carefully so limited its holding." 539 F.2d at 881. Therefore, the *Goldwater* court did not feel bound to apply *Borax* to a surviving spouse deduction in § 2057 of the Code. The *Borax* opinion, however, does not appear limited to alimony deductions. The *Borax* court was concerned with a " 'uniform construction' " of the marital status provisions of the Internal Revenue Code. 349 F.2d at 675. By limiting *Borax* to a particular section of the Code, the *Goldwater* decision overlooked one of the major justifications the *Borax* court relied on for its rule of validation — a uniform marital status standard under the Code.

66. As Judge Friendly noted in his *Borax* dissent, although the court was divided on the holding, the judges all agreed that federal courts should not "set themselves up as domestic relations tribunals." 349 F.2d at 676.

accept the view of some other jurisdiction, state or foreign; they do not *sua sponte* invalidate state divorce decrees in "these most collateral tax deficiency proceedings."[67]

In Revenue Ruling 76-255, the IRS argues that a couple may comply with formal state requirements for divorce, yet continue to live in a manner so indistinguishable from marriage that the divorce decree should be disregarded for tax purposes.[68] But a federal court that unilaterally invalidated a state divorce decree would create an independent federal law of marriage. Courts since *Eccles* have always interpreted the marriage provisions of the Code to avoid such a consequence. Since Congress has never indicated that it wants to ignore state divorce decrees, the implicit IRS assumption of a clear congressional purpose is cryptic.

B. *The "Marriage Penalty" and Congressional Purpose*

Even if Congress did desire the courts to fashion a federal law of marital status wholly independent of state laws, *Gregory* requires a more specific congressional purpose before the sham doctrine is appropriate. The Service is likely to argue that Congress thought that the "marriage penalty" was a necessary evil to institute more equitable tax rates for single persons. But that alone is surely not a sufficiently specific purpose to warrant the use of the sham doctrine.[69] On the other hand, the Service might argue that Congress wanted to tax all married couples in which both spouses earn significant incomes at a higher rate than similarly situated single couples and that the sham doctrine is the only feasible way to vindicate that goal. To see whether that goal takes a form clear enough to justify the extraordinary measures of

67. 349 F.2d at 670.

68. An argument by the Commissioner for federal standards to determine marital status under the Code may place the Service in an embarrassing position. After the *Borax* decision, the IRS repudiated it in Rev. Rul. 67-442. According to the Ruling, the Commissioner:

> generally will not question for Federal income tax purposes the validity of any divorce decree until a court of competent jurisdiction declares the divorce to be invalid. . . . In this regard the Service will not follow the decisions in *Estate of Herman Borax v. Commissioner* and *Harold E. Wondsel v. Commissioner*. . . .
>
> G.C.M. 25250 is clarified to remove any possible implication that the Service will follow invalidated divorce decrees for Federal income tax purposes.

1967-2 C.B. 65, 66.

Of course, neither the courts nor the Service are bound by the Revenue Ruling. Estate of Lang v. Commissioner, 64 T.C. 404, 406-07 (1975). Unfortunately for the Commissioner, however, the courts have given Rev. Rul. 67-442 "general applicability." Wilson v. Commissioner, 35 Tax Ct. Mem. Dec. 1276, 1279 (1976).

69. *See* note 37 *supra* and accompanying text.

Gregory v. Helvering, one must review the development of the tax laws and the confused legislative history of the 1969 Tax Reform Act.

The tax laws have always sought to treat individuals with equal incomes equally.[70] The Revenue Act of 1913 contained only one schedule, which applied to all individuals.[71] Similarly, the first joint return provision, passed in 1918, set forth one rate for all married couples, whether they filed separately or jointly.[72] In the 1930s, Congress noticed that married couples living in common law states were taxed at a higher rate than those living in community property states.[73] Community property statutes split a married couple's income equally between each spouse, no matter how much each spouse earned, and spared the couple's high earner some of the pains of progressive taxation. Desiring to tax all couples equally, regardless of their states of residence, Congress enacted a provision in 1948 allowing all married couples filing a joint return to be taxed at rates that were twice what a single person earning one-half of the couple's joint income would pay.[74] By setting joint rates on a par with the rates paid in the community property states, Congress gave all married couples the advantages of income splitting. The plan admirably served one congressional purpose — equal taxation of all couples, regardless of state of residency. Moreover, for couples in which both spouses earn equal incomes, it ensured equal taxes for all individuals, regardless of marital status. But it created a new discrepancy: a married individual whose spouse earned no income was now taxed at a much lower rate than a single individual. Not surprisingly, single workers cried "Foul!"

In 1969, Congress responded to the demands of single taxpayers by reducing their rates so that an individual would never pay more than one hundred twenty percent of the taxes paid by a married person with the same income.[75] Standing alone, such a

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70. *See generally* Jensen, *The Historical Discrimination of the Federal Income Tax Rates*, 54 TAXES 445, 452 (1976).

71. Tariff of 1913, ch. 16, 38 Stat. 114, 166-81.

72. Revenue Act of 1918, ch. 18, § 223, 40 Stat. 1057, 1074 (1919).

73. *See* Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1400-09 (1975); Note, *Federal Income Tax Discrimination Between Married and Single Taxpayers*, 7 U. MICH. J. L. REF. 667, 672-74 (1974).

74. Revenue Act of 1945, Pub. L. No. 80-471, ch. 168, § 301, 3 Stat. 110, 114. The Senate Finance Committee Report on the 1948 Revenue Act states that the adoption of the Act "will produce substantial geographical equalization in the impact of the tax on individual incomes." S. REP. No. 1013, 80th Cong., 2d Sess., 25 (1948).

75. S. REP. No. 91-552, *supra* note 2.

change would have allowed couples in community property states to file separately under the new individual rates and pay less tax than similar couples in common law states. Careful to avoid recreating such a disparity, Congress qualified the 1969 amendment with a rule that married couples could file separately only if they used the pre-1969 individual rates.[76] That rule successfully averted the common-law / community-property disparity but inadvertently created the "marriage penalty."

As other commentators have explained,[77] the problem is one of irreconcilable goals. Under a progressive tax structure, it is impossible to

1) Tax all married couples equally, regardless of the distribution of income within the couple (the goal of the 1948 reform),
2) Tax all single individuals at a rate little higher than the rate applied to an individual earning the same income but married to a nonearning spouse (the goal of the 1969 reform), and,
3) Tax all married couples at rates no higher than they would face if they were single (the avoidance of a "marriage penalty").

To justify the use of the sham doctrine, the IRS might argue that the steps Congress took in 1969 to protect the first and second goals imply a clear desire to overrule the third. Such reasoning would have merit if at the time of its actions Congress understood all the implications. Such is not the case.[78] During the 1972 House Ways and Means Committee Hearings testimony diverged over Congress's knowledge of the existence of the marriage penalty when it passed the 1969 Tax Reform Act. New York Representative Bella Abzug testified: "The problem of the working married couple who must pay higher taxes than two single working people living together appears to be the result of an oversight in the drafting of the Tax Reform Act of 1969."[79] On the other hand, Iowa Representative Fred Schwengel testified, "This so-called 'marriage penalty' was noted by the tax writing committees at the time, but it was justified on the

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76. *See* Bittker, *supra* note 73, at 1429.

77. *See id.* at 1430; *Hearings, supra* note 3, at 78-95 (statement of Edwin S. Cohen).

78. As one author stated:

> [T]he historical development of the current tax rate structure raises significant doubt that the discrimination between married and single taxpayers is indicative of any conscious congressional plan or policy. Rather, it appears that the present allocation of tax burdens is the unintended and conglomerate result of a series of ad hoc congressional reactions to public pressure.

Note, *supra* note 73, at 678.

79. *Hearings, supra* note 3, at 122 (statement of Representative Abzug).

grounds that a couple's living expenses are likely to be less than those of two single persons."[80]

The legislative history of the 1969 Tax Reform Act supports the former view, if it supports either. The Senate Report that accompanied the Act[81] is devoid of reference to a marriage penalty. If such a consequence were fully intended, the absence of either justification or dissent would be difficult to explain.[82] Surely Congress would have recorded any clear desire to impose so controversial a measure as the marriage penalty.[83]

But must we not presume that Congress intended all the necessary consequences of its actions? Perhaps. Yet we need not presume so strong an intent that courts should take extraordinary measures to vindicate it. In light of the provision's complete his-

80. *Hearings, supra* note 3, at 100 (statement of Representative Schwengel).

81. S. REP. No. 91-552, 91st Cong., 1st Sess. (1969).

82. The *General Explanation of the Tax Reform Act of 1969,* written by the staff of the Joint Committee on Internal Revenue Taxation, is the only document related to the Act that mentions the marriage penalty. However, by its own admission, the *General Explanation* is not a statement of congressional intent but "an attempt by the staff to write the equivalent of what it believes would be the type of explanation which might have been prepared with respect to the legislation as finally enacted if the legislative process called for such an explanation." STAFF OF JOINT COMM. ON INTERNAL REVENUE TAXATION, 91ST CONG., 1ST SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, at III (Dec. 3, 1970). Hence the document is nothing more than an after-the-fact justification of the effect of the Act. Furthermore, the *General Explanation*'s reference to the marriage penalty suggests Congress was unaware of its existence at the time it passed the Act:

> With the new rate schedule for single persons, married couples filing a joint return will pay more tax than two single persons with the same total income. This is a necessary result of changing the income-splitting relationship between single and joint returns. Moreover, it is justified on the grounds that although a married couple has greater living expenses than a single person and hence should pay less tax, the couple's living expenses are likely to be less than those of two single persons and therefore the couple's tax should be higher than that of two single persons.

Id. at 223. A statement of justification normally presupposes the author's knowledge of the condition justified. However, the term "moreover" indicates that Congress did not contemplate the living expense justification for the marriage tax when it passed the Act. Instead, it appears that the drafters of the *General Explanation* constructed what they felt to be a reasonable explanation for the enigmatic imposition of the marriage tax.

83. The 1978 Revenue Act, Pub. L. No. 96-600, § 101, 92 Stat. 2763, 2767 (current version at I.R.C. § 1), revised tax rates for married couples as well as single individuals, thereby reducing the "marriage tax." For example, prior to the 1978 revisions if each spouse earned $15,000, the couple would pay $1205 more than their single counterparts. Under the 1978 Act the marriage tax would be approximately $957, or about $248 less. Regrettably, the reports accompanying the 1978 Act do not specify whether Congress intended to reduce the disparity between dual-earning couples and single taxpayers. If anything, the revision indicates that Congress was displeased with the marriage penalty it had imposed nine years earlier. If Congress lacked sufficient intent to fortify the marriage tax with the sham doctrine in 1969, it would be difficult to construe the 1978 Act as evidencing a stronger intent to do so.

tory, Congress's silence concerning the marriage penalty, and the presumption against creating a federal law of marriage, it seems inappropriate to take the commercial sham doctrine and apply it to year-end divorces.

III. The Year-End Divorce and the Suitability of Sham Doctrine Tests

Even if one were to conclude that year-end divorces undermine a congressional purpose, one must still ask whether, given the personal and intimate character of marriage and divorce, the sham doctrine is an appropriate tool to achieve that purpose. In the past, courts have employed the doctrine to assess the tax consequences of business transactions. The remarks of the Second Circuit are typical: "The doctrine of Gregory v. Helvering means that in construing words of a tax statute which describe commercial or industrial transactions we are to understand them to refer to transactions entered upon for commercial or industrial purposes . . . ."[84] Should this commercial doctrine be transplanted to the family setting? The answer should certainly turn in part on whether either of the current sham doctrine tests are properly tailored to separate cases that violate congressional purposes from cases that do not.

A. *The Beneficial Interest Test*

It is not at all clear that courts using the beneficial interest test would *ever* strike down a year-end divorce and remarriage as a sham. Unlike those commercial transactions that courts have found not to change a taxpayer's position significantly, dissolution of marriage always carries significant risks that are largely beyond the couple's control. In many regions of the country and many social circles, divorce still carries a powerful stigma. That stigma may impair social relations with family, close friends, or the community at large; for some it may even impair job oppor-

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84. Commissioner v. Transport Trading & Term. Corp., 176 F.2d 570, 572 (2d Cir. 1949), *cert. denied,* 338 U.S. 955 (1950). At least one court, however, has suggested that the sham doctrine is applicable to domestic relations. In Chisholm v. Commissioner, Learned Hand stated that in sham cases:

> The question always is whether the transaction under scrutiny is in fact what it appears to be in form; a marriage may be a joke; a contract may be intended only to deceive others; an agreement may have a collateral defeasance. In such cases the transaction as a whole is different from its appearance.

79 F.2d 14, 15 (2d Cir.), *cert. denied,* 296 U.S. 641 (1935).

tunities. More significantly for the purposes of the beneficial interest test, year-end divorce and remarriage imposes several inescapable financial risks, most of which are tied to the possibility that one or both partners might die or become incompetent during the period of separation. If one spouse dies intestate during some excessive New Year's festivities, the other will be without the statutory protections accorded a surviving spouse.[85] Even if both spouses made wills before the divorce, an untimely death during the separation can have many undesired effects on the legal dissolution of the estate,[86] including forfeiture of the estate-tax marital deduction[87] and in some jurisdictions automatic revocation of all bequests to the divorced spouse.[88] Finally, each party to a year-end divorce runs a personal risk that should not be ignored: the partner may enjoy being divorced and choose not to remarry. This risk is not easily quantified, and for some marriages a disinterested spectator might well characterize it as a possible fringe benefit, but it must surely play some role in the parties' decision to proceed with their plan.

Of course, one might say that such risks make it clear that the year-end scheme is *not* in the "beneficial interest" of the parties when the tax consequences are not considered. But as we saw in the commercial setting,[89] the test is intended to weed out only those transactions that are not "significant." The courts do not step in and decide whether the parties were wise; they only decide whether the risks were so insignificant that the parties never moved their eyes from the Internal Revenue Code. It is hard to imagine any year-end divorce and remarriage fitting that description.

85. *See, e.g.*, UNIFORM PROBATE CODE § 2-102.

86. It will not help the Service if the Court limits its evaluation of the risks attendant to a divorce to financial considerations. Perhaps even more significant than the social consequences of a divorce are the economic ones. If the couple does not remarry, they may lose the benefits of spousal insurance policies and social security benefits. Property held by tenancy in the entirety may become a tenancy in common. Although some of these risks might be reduced by contracts prior to the year-end divorce, many — such as federal benefits — cannot be controlled. For a general discussion of some of the economic risks in a year-end divorce, see Feld, *Divorce, Tax-Style*, 54 TAXES 608, 610 (1976).

87. I.R.C. § 2056.

88. *See, e.g.*, UNIFORM PROBATE CODE § 2-508. Even in those states without statutory revocation provisions, a divorce greatly magnifies the threat of a will contest by other devisees of the will. *See, e.g.*, *In re* Estate of Blanchard, 391 Mich. 644, 218 N.W.2d 37 (1974); Caswell v. Kent, 158 Me. 493, 186 A.2d 581 (1962). For a general discussion and collection of cases concerning the effects of divorce on a will, see R. WELLMAN, L. WAGGONER & O. BROWDER, PALMER'S TRUSTS & SUCCESSIONS 231-48 (3d ed. 1978).

89. *See* text at notes 24-31 *supra*.

B. *The Motive Test*

The beneficial interest test is objectionable because there may be no year-end divorce and remarriage schemes that would violate its standards. In contrast, the motive test would surely strike down some such schemes. Nonetheless, the motive test may still not be an appropriate way to vindicate a congressional desire to impose a marriage penalty.

The motive test is invasive. It requires a court to probe the desires of an individual by seeking circumstantial evidence of purpose. In a commercial context, courts have tolerated the test where that evidence was easily obtained. In *Gregory*, for example, the Supreme Court found the reorganization to be tax-motivated by exploring the business records of Averill and discovering that the company performed no business functions and served no economic purpose apart from gaining a tax benefit.[90] But when the circumstances are murkier, courts have shunned motive investigations even in commercial contexts. In *Granite Trust Co. v. United States*,[91] a corporate taxpayer wanted to liquidate a wholly owned subsidiary. To ensure that the liquidation would not create a nonrecognizable loss under section 112(b) of the 1939 Code[92] or section 332 of the 1954 Code,[93] the company reduced its ownership to less than 80% by selling shares to friends who knew the company would be liquidated. The IRS challenged the transaction as circuitous and without "independent purpose," but the First Circuit held otherwise:

> To strike down these sales on the alleged defect that they took place between friends and for tax motives would only tend to promote duplicity and result in extensive litigation as taxpayers led courts into hairsplitting investigations to decide when a sale was not a sale. It is no answer to argue that, under Gregory v. Helvering, there is an inescapable judicial duty to examine into the actuality of purported corporate reorganizations, for that was a special sort of transaction, whose bona fides could readily be ascertained by inquiring whether the ephemeral new corporation was in fact transacting business, or whether there was in fact a continuance of the proprietary interests under an altered corporate form.[94]

It is difficult to imagine a more hair-splitting investigation

90. As one author noted, the facts in *Gregory* were "entirely clear." R. PAUL, STUDIES IN FEDERAL TAXATION 152 (1937).

91. 238 F.2d 670 (1st Cir. 1956).

92. Int. Rev. Code of 1939, ch. 1, § 112(b), 53 Stat. 36.

93. Int. Rev. Code of 1954, ch. 1, § 332, 68 Stat. 102.

94. 238 F.2d at 677-78.

than one to seek the impetus behind a valid divorce. One commentator has described the factual problems in adversarial divorce litigation in a manner that illuminates the even greater difficulties present here: "Truth is not discernible in a divorce case since the factual history of a crumbling marriage is usually too complex to allow the assessment of facts in terms of truth or untruth."[95] But at least in divorce litigation, the parties with access to the information are opposed, and therefore have incentives to present evidence on both sides of disputed issues. In tax litigation, the parties have no incentive to go beyond presentation of the state decree of divorce and any evidence they may have produced to gain that decree.[96]

Possibly out of sensitivity to these problems, the Commissioner seems to have set a limit to the types of year-end divorces the IRS will challenge. In Letter Ruling 7835076,[97] a couple asked the Service whether it would challenge a purely tax-motivated divorce where the parties continued to cohabit but did not remarry. Although the Commissioner noted that the only change in the couple's lives would be a purely legal one, he stated that the Service would not challenge the divorce.[98] That position is reassuring, but it draws a line that is not defensible as an expression of the motive test's standards to advance a congressional purpose. If Congress wanted the IRS to apply a sham doctrine motive test

95. Feldman, *A Statutory Proposal to Remove Divorce from the Courtroom,* 29 ME. L. REV. 25, 31 (1977).

96. In states where grounds are required, the decree would evidence the existence of other motivations for the divorce besides a reduction of taxes. Even no-fault states require a demonstration that " 'there has been a breakdown of the marriage relationship to the extent that the legitimate objects of marriage have been destroyed and there remains no reasonable likelihood that the marriage can be preserved' " before a court grants a decree of divorce. Raphael, Frank, & Wilder, *Divorce in America: The Erosion of Fault,* 81 DICK. L. REV. 719, 729 (1977).

An interesting question is whether the courts will extend the general presumptions presently enjoyed by the Commissioner to ease the difficulty of proof for the Service, and if so, what weight the courts will give the valid state decree. Case law demonstrates two burden-shifting devices. The first is the general rule that the Commissioner "has the support of a presumption of correctness, and the petitioner [taxpayer] has the burden of proving it to be wrong." Welch v. Helvering, 290 U.S. 111, 115 (1933). This presumption has been extended by some courts to sham questions. For example, see Hoffman Motors Corp. v. United States, 473 F.2d 254, 258 (2d Cir. 1973). The second doctrine that may benefit the Service is that transactions between family members which reduce taxes are subject to strict scrutiny. *See* Helvering v. Clifford, 309 U.S. 331, 335 (1940); Commissioner v. Tower, 327 U.S. 280, 291 (1946). However, because year-end divorces would regain such strict scrutiny, courts may balk at the invitation to enmesh themselves further into intimate family relations.

97. Ltr. Rul. 7835076 (June 1, 1978).

98. *Id.*

to protect the marriage penalty, it surely would expect the Service to strike down all tax-motivated divorces, whether or not the couple remarried later. For purposes of the motive test, the letter ruling's hypothetical, which stipulated a tax-motivated divorce, is indistinguishable from the situation governed by Revenue Ruling 76-255.

Perhaps the Commissioner issued the letter ruling to avoid being forced later to decide when a couple that divorces and cohabits becomes "divorced" for tax purposes. Unfortunately, Revenue Ruling 76-255 imposes a similar problem: to decide how long a cohabiting couple must remain divorced before it is presumed that the parties did not intend to remarry at the time of their divorce. Perhaps the Commissioner did not want to become entangled in difficult factual investigations to distinguish friendly divorces from tax-motivated divorces. But as we have seen above,[99] such a consideration could affect challenges to year-end divorces under Revenue Ruling 76-255. It seems clear that the Commissioner's line is one of administrative and evidentiary convenience. If, at some future date, the IRS chose to challenge a divorce under circumstances similar to those treated in the letter ruling,[100] it could surely find every bit as much support from the motive test as it presently finds for Revenue Ruling 76-255.[101]

Thus, application of the motive standard to year-end divorces authorizes the IRS and the courts to delve into the domestic affairs of any divorced couple. If used to promote a congressional desire to tax married couples more heavily than single individuals, it is alarmingly open-ended. Notwithstanding Letter Ruling 7835076, the test itself suggests no dividing lines and mires courts in domestic inquiries that they have studiously avoided in other tax cases.[102] It then forces them to create a federal marital status despite the longstanding tradition of relying on the marital status determinations of a state or foreign jurisdiction to make federal tax decisions. Thus, the motive test seems an undesirable way to apply the sham doctrine to year-end divorce and remarriage.

99. *See* text at notes 95-96 *supra.*

100. Similar to a revenue ruling, the private ruling is not binding on the Commissioner nor on the courts. *See* Rev. Proc. 76-29, 1976-2 C.B. 646.

101. By restricting the advantages of a tax-related divorce in Ltr. Rul. 7835076 (June 1, 1978), the Commissioner has already forced tax factors into the decision to remarry. The possibility of a more extensive application of the Rev. Rul. 76-255 position would further hamper socially desirable reconciliation since resumed relations would raise the specter of a tax penalty.

102. *See* notes 39-62 *supra* and accompanying text.

Conclusion

Revenue Ruling 76-255 seems misconceived. Although courts have established that local law determines marital status for tax purposes, the Ruling invokes sham doctrine to challenge divorces issued according to proper local procedures. The doctrine does not fit the gap into which the Internal Revenue Service has tried to wedge it. In commercial contexts, it is used to protect a clear congressional purpose; however, it is debatable that Congress intended to question valid state divorce decrees and to create a marriage penalty. Furthermore, even if a year-end divorce and remarriage scheme contravenes a congressional desire, the sham doctrine is not an appropriate remedy. Neither of the sham doctrine tests adequately explains the Commissioner's analysis of different year-end divorce situations, and any form of sham analysis would require courts to pierce the marriage veil with an analytic knife previously reserved for commercial transactions.[103] Under the beneficial interest test, a year-end divorce would never be stricken as a sham because it inevitably exposes the couple to substantial, albeit brief, risks associated with loss of the legal, economic, and emotional benefits of marriage. The motive test, on the other hand, would plunge courts into hair-splitting factual investigations under circumstances inconducive to productive inquiry. Whatever a couple's motivations for divorce, is it appropriate to expose them to IRS scrutiny?[104] And should a couple that

103. Applying the sham doctrine necessarily injects uncertainty into relations, whether commercial or domestic. Herman Fuller has described succinctly the tradeoff between fully enforcing congressional desires through the sham doctrine and uncertainty:

> If [sham cases] are limited in application to the extreme situations in which they originate, they do not solve the problems which give rise to them; if they are applied more sweepingly by an activist judiciary, the impossibility of predicting the outcome of more questionable cases tends to undermine certainty.

Fuller, *supra* note 32, at 375. While we begrudgingly tolerate a limited amount of uncertainty in business transactions, it is especially troubling in family relations. Indeed, the history of the Internal Revenue Code is replete with condemnations of interference with such intimate decisions. For example, when Congress was considering a mandatory joint return in 1941 to combat the inequalities created by community property states, the critics clamored their disapproval: "Of course, the provision was 'un-American.' The contention was that by making the marital relation a taxable privilege the 'sly and tricky' provision was arbitrary and against public policy in that it struck at the institution of marriage, was an attack upon the family, and promoted celibacy." R. Paul, Taxation in the United States 275 (1954).

104. Some observers believe that overly intrusive divorce proceedings (and by analogy, overly intrusive inquiries into the validity of a divorce by the IRS) may seriously undermine the institution of marriage:

> The requirement of disclosing in open court or in the lawyer's office any of the various grounds for divorce such as adultery, intemperance, or cruelty entails a

is deemed divorced and free to remarry by the court of their marital domicile be deemed joined in the bonds of matrimony for federal tax purposes?

Admittedly, year-end divorce and remarriage schemes are troublesome tax avoidance devices. They violate notions of fair play and equity. But if Congress is genuinely offended by the schemes, it can attack them through direct, bright-line rules.[105] The IRS should not be allowed to lead the assault by applying a business doctrine to the most intimate societal unit.

> public exposure of the most intimate and often embarrassing details of married life. . . . Such state-sponsored invasions of privacy in divorce contests can only demean the marriage relationship, humiliate the parties, and damage the residual family relationships, whatever the outcome of the contest.

Goldstein & Gitter, *Divorce Without Blame*, 30 HUMANISTS No. 3, 12, 14 (1970).

105. If Congress genuinely believes that year-end divorce schemes frustrate its purpose, the solution is remarkably simple. Section 143 could be amended to provide that a person must be single at least six months of the calendar year in order to qualify for singles tax rates. Congress's failure to adopt this device when it first passed § 143 suggests that it was not so concerned with whether a taxpayer's marital status for tax purposes reflects that person's legal marital status for most of the year. Instead, Congress only wanted a simple, straightforward rule for ascertaining marital status for tax purposes. Thus, it chose to rely upon an individual's legal marital status as of a given date—December 31. If Congress now finds the rule too lax, it should not rely on the courts to tighten it. *See* Hanover Bank v. Commissioner, 369 U.S. 672, 688 n.23 (1962), where the Court stated:

> We believe the Court of Appeals for the First Circuit was correct when it said in Fabreeka Products Co. v. Commissioner, 294 F.2d 876, 879: "Granting the government's proposition that these taxpayers have found a hole in the dike, we believe it one that calls for the application of the congressional thumb, not the court's."